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31 March 2004

Dear Directors

Probity and Governance Advice PricewaterhouseCoopers (PwC) Report into Foreign Exchange Losses

In our letter of 12 March 2004, we expressed the opinion, based on our observations and enquiries and having regard to the matters outlined in that letter, that PwC was reasonably likely to be regarded as being independent for the purpose of providing its report into foreign exchange losses at the National (**the Report**). In expressing this opinion we had regard to the matters raised in a letter from Mrs Catherine Walter dated 3 March 2004.

Mrs Walter has subsequently written to the Chairman on 16, 17 and 21 March 2004 and issued a media statement dated 26 March 2004. In the light of the comments made by Mrs Walter in these letters and the media statement, you have asked us to:

- A. amplify the steps taken by us in forming the opinion as to independence which we expressed in our letter of 12 March 2004; and
- B. comment (from a probity perspective) on the issues raised about which we have direct knowledge.

A. Matters taken into account in our opinion as to the "independence" of PwC

In expressing the opinion in our letter of 12 March 2004, we had regard to certain indicia of independence, drawn from established authority in other contexts and to good probity and governance practice. For an expert's report to be regarded as independent, it must satisfy four main tests. We set out below our comments in respect of the application of each test.

1. *The expert must disclose any information which readers need to assess for themselves the expert's impartiality*

At the commencement of our assignment, you informed us that the National has established commercial relationships with a number of major accounting firms. In the

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case of PwC, this included provision of seconded staff to the National and the establishment of a Strategic Alliance to provide internal audit services as required.

The Disclosure Statement published in the Report (p.iii) sets out relationships with the National. Prior to publication of the Report we satisfied ourselves of the accuracy and completeness of that information, first against the National's own records and secondly through interviews with National employees and PwC personnel. We are not aware of any information other than that set out in the Disclosure Statement which readers need to assess for themselves PwC's impartiality.

2. *The expert's report must not be commissioned after shopping the brief around for an expert who will give a favourable report*

We have made our own enquiries as to the circumstances surrounding the commissioning of the Report by the National on 16 January 2004. We are unaware of any evidence to support the view that the brief was assigned to PwC after approaches to other experts or on the basis that PwC would provide a favourable report.

3. *The expert's report must not result from successive drafts circulated to and amended following discussion with those commissioning it, except to correct factual matters*

We made our own enquiries as to the circumstances surrounding the provision of progress briefings during the course of the PwC investigation (including questioning of relevant persons) and whilst the Report was in preparation. High level "Status Update Briefings" with summaries of progress were provided by the PwC investigation team to the PBRC and later to the full board.

We established and monitored a protocol to ensure that PwC did not invite or consider amendments, other than corrections of factual matters. We reviewed the summary documents which were provided to members of the PBRC. We are not aware of any breach of that protocol or any inappropriate interference or direction by the PBRC or board.

4. *The expert must be unbiased -the more extensive the relationship between the expert and the company, the greater the onus on the expert to demonstrate absence of bias*

We tested for evidence of bias by interviewing the PwC investigation personnel and National directors and employees, attending meetings between them and attending the briefing by PwC of the board. No evidence of bias came to our attention.

We were aware that the majority of PwC investigation interviews had been attended by the regulator, Australian Prudential Regulatory Authority (APRA), which we are informed also received transcripts of all the interviews conducted by PwC.

APRA confirmed that it was utilising the resources of PwC to gain access to relevant information about the foreign exchange options trading and relevant aspects of the National's risk management framework. However, APRA advised that it would reach its own judgements on the basis of this information and its own investigations. We

were assured by APRA that the combined investigative work would not continue if APRA had concerns regarding the conduct of the investigation by PwC.

This provided to us some corroborative evidence that PwC were bringing an independent mind to bear in their investigations.

B. Issues raised by Mrs Walter - Summary

There is a large number of issues raised in this correspondence which call into question the procedural integrity of the process and the independence of the Report. We have prepared a table identifying these issues. They generally fall into the following categories:

(a) *Inappropriate direction from members of the Principal Board Risk Committee (PBRC) to PwC*

Protocols for the conduct by PwC of their investigations and enquiries were established by us. We are not aware of any occasion on which those protocols were not observed. We are not otherwise aware of any inappropriate interference or direction by members of the PBRC or the board generally.

(b) *Failure of PwC, Deloitte or BDW to take into account factual matters raised by Mrs Walter*

To the extent that Mrs Walter's comments relate to issues of procedural integrity, her comments fall into the following main categories: the role of PwC personnel working on National projects (including on Horizon software) and on secondment, the PBRC, reporting as to the consideration of certain APRA letters, and the role of Internal Audit. Mrs Walter raised these issues at various times during the period of our engagement. The issues were variously included in letters, interviews with us and Deloitte, in written responses, with PwC at the Board meetings of 9 and 11 March and with Deloitte at the Board meeting on 11 March. We are satisfied that this provided adequate opportunity for these issues to be taken into consideration by PwC and Deloitte in arriving at their conclusions. These matters were taken into consideration by us in our opinion of 12 March 2004.

(c) *Lack of full disclosure to BDW (and Deloitte) of all material facts such that our brief was "circumscribed"*

From the commencement of our engagement we had full and free access to documents, National staff and consultants. We were encouraged to be robust and rigorous in our work. No attempts were made to restrict or direct our review of material or interviews with staff. We obtained full cooperation at all times.

The same access was given to Deloitte in their review. In her letter of 21 March Mrs Walter states that Deloitte "had no access to PwC documents". At the Board meeting of 11 March, directors were given an opportunity to question Deloitte directly and to test whether they (Deloitte) considered that their own

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work had been inappropriately restricted or directed in any way. To our observation, Deloitte were given full access to PwC's documents.

The above comments are a summary of an analysis we have undertaken of the issues raised by Mrs Walter in her letters of 3 and 21 March 2004 and the media release, to the extent they relate to the integrity of the process followed by PwC in completing the Report. Some of the issues raised by Mrs Walter in her letters (including all issues raised in her letters of 16 or 17 March 2004) are outside the scope of our retainer or our knowledge and we are therefore not in a position to comment on them. These are not matters in relation to the scope of the Report or the processes by which it was prepared.

In summary, there is nothing in Mrs Walter's letters to the Chairman dated 16, 17 or 21 March 2004 or her media release dated 26 March which causes us to withdraw, amend or qualify our probity and governance opinion of 12 March 2004.

Yours faithfully


BLAKE DAWSON WALDRON